

# Audit of Performance Bonds

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October 2004



# **OPR 04-03 Audit of Performance Bonds**

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## **Introduction**

The Office of Performance Review conducts audits to insure the quality of transactions, check financial records against budgeted statements, and to insure monetary validity when necessary. Contracts, especially contracts within the City of Chattanooga, must carry certain aspects of reassurance and legal stability. When a contract is made, a bond is attached, and strict guidelines are set. The legalities of the arrangement define quality, ensure compensation within a certain time frame, and provide goals in which to assess the job being performed.

## **Summary**

The Office of Performance Review conducted a review of Performance Bonds, Payment Bonds, and attached General Power of Attorney forms within contracts held by the City of Chattanooga to determine their validity. These nine contracts were picked from the period beginning April 8<sup>th</sup>, 2002 to July 26<sup>th</sup>, 2004. These contracts included expenditures and monetary operating levels beginning at \$207,752 and ending at \$9,727,000. OPR staff found that the bonds were valid.

## **Scope**

OPR staff first directed their attention to the Purchasing Department, and contacted Artie Prichard – Purchasing Agent for review of the selected bonds. The contracts obtained are listed:

**---Department---**  
**Purchasing and Finance (Annex Building)**  
**Contact: Artie Prichard**

Performance Bond	Contractor	Owner	Bond Holder (Surety)	A.M. Best Rating	Bond Date	Amount	Description	Agent or Broker	Owner's Representative
AIA Document A312™ - 1984	Tower Construction Company	City of Chattanooga	North American Specialty Insurance Company	A+ Superior	July 19th, 2004	\$207,752.00	Whiteside Park 700 Block ML King Blvd.	Brock Insurance Company	Polis Studio, LLC
AIA Document A312™ - 1984	The Strauss Company, Inc.	City of Chattanooga Fire Department	Westfield Insurance Company	A Excellent	Sept 13th, 2004	\$213,400.00	Alterations and Additions to the Fire Training Center 3200 Amnicola Highway	Brock Insurance Company	Franklin Associates, Architects, Inc.
AIA Document A312 - Electronic Format	The Strauss Company, Inc.	City of Chattanooga Depart. Of Parks, Recreation, Arts, and Culture	Westfield Insurance Company	A Excellent	Oct 3rd, 2003	\$1,338,658.00	DuPont Soccer Complex at North Access Road	Brock Insurance Company	March Adams & Associates, Inc.
AIA Document A312™ - 1984	Tower Construction Company	City of Chattanooga Depart. Of Parks, Recreation, Arts, and Culture	North American Specialty Insurance Company	A+ Superior	July 26th, 2004	\$452,000.00	Washington Hills Recreation Center 4628 Oakwood Drive	Brock Insurance Company	Artech Design Group, Inc.

A second review was done, and more information was taken from Public Works Department of the Developmental Resource Center. Our contact for performance bonds was Ed Bowen – City Engineer. The contracts obtained are also listed:

**---Department---**  
**Public Works – City Engineering (DRC)**  
**Contact: Ed Bowen**

Performance Bond	Contractor	Owner	Bond Holder (Surety)	A.M. Best Rating	Bond Date	Amount	Description	Agent or Broker	
Bond# 81564416 Worksheet (Generic/General)	Vulcan Constructon Materials, LP	City of Chattanooga	Federal Insurance Company	A++ Superior	April 16th, 2004	\$1,437,395.00	Bitumimous Pavement Resurfacing	Chubb Insurance	
Contract # 81-C Worksheet (Generic/General)	East Tennessee Grading, Inc.	City of Chattanooga	Fidelity and Deposit Company of Maryland	A Excellent	April 8th, 2002	\$588,201.00	Sewer Relocation for Widening of Signal Mountain Boulevard	Brock Insurance Company	
Contract # 28K2 Worksheet (Generic/General)	Max Foote Construction Company, Inc.	City of Chattanooga	St. Paul Fire and Marine Insurance Company	A Excellent	Oct 31st, 2002	\$9,727,000.00	Moccasin Bend Wastewater Treatment Plant	Seaboard Surety Company	
Contract # 28J2 Worksheet (Generic/General)	H&H Brown, Inc.	City of Chattanooga	Great American Insurance Company	A Excellent	June 26th, 2003	\$1,501,000.00	Installation of Oxygenation Equipment and Accessories Moccasin Bend		
Contract # W-03-002 Worksheet (Generic/General)	Talley Construction Company, Inc.	City of Chattanooga	Western Surety Company	A Excellent	April 7th, 2004	\$1,297,667.07	Market Street Storm Drainage and Intersection Improvements	Brock Insurance Company	

## **Objective**

The main objective of the audit is to determine the validity of the performance bonds obtained, and to recommend the best methods to check these bonds for authenticity.

## **Methodology**

OPR staff obtained each contract in full, looked through the information, and pulled out the performance bonds, payment bonds, and the attached general power of attorney forms. OPR staff made copies of said forms, and compared the information on each bond. The bond information was used to contact the insurance companies holding insurance for the bond, and to contact the contractor under each bond. OPR staff also contacted the number given on the power of attorney forms. OPR staff also searched the A.M. Best website for ratings. The State of Tennessee website was found to have information to search out the contractors through a roster listing and license description.

## **Findings**

All contracts were found to be valid. OPR staff reviewed all the contracts currently listed, and followed the steps mentioned in the recommendations for checking the validity of the Power of Attorney forms attached, it was clear that the contracts were authentic and backed by a reputable surety.

In the A.M. Best website search we found that all insurance companies known to be surety representatives for the performance bonds were rated from A Excellent to A++ Superior. In the Tennessee website search, the contractors listed have active and current contractor licenses.

Currently Mike McMahon City Attorney checks major city contracts using the following steps:

- a. Review Power of Attorney forms for proper signatures and corporate/original seals.
- b. Checks Bonding/Surety Company for solvency. Go to [www.ambest.com](http://www.ambest.com) to verify if the bonding company is solvent.

Legislation was found on internet search describing the validity of performance bonds and accompanying attachments. Below is the information found:

## **The Miller Act – Surety Information Office**

[Surety Information Office](http://www.sio.org) | [www.sio.org](http://www.sio.org)

The Information Source on Surety Bonds in Construction

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In the United States, the law requiring contract surety bonds on federal construction projects is known as the Miller Act (40 U.S.C. Section 270a to 270f). This law requires a contractor on a federal project to post two bonds: a performance bond and a labor and material payment bond. The surety company issuing these bonds must be listed as a qualified surety on the **Treasury List** at <http://www.fms.treas.gov/c570/c570.html>, which the U.S. Department of the Treasury issues each year.

The Miller Act provides that, before a contract that exceeds \$100,000 in amount for the construction, alteration, or repair of any building or public work of the United States is awarded to any person, that person shall furnish the United States with the following:

1. A performance bond in an amount that the contracting officer regards as adequate for the protection of the United States. The bond amount is normally 100 percent of the contract price.

2. A separate payment bond for the protection of suppliers of labor and materials. The amount of the payment bond shall be equal to the total amount payable by the terms of the contract unless the contracting officer awarding the contract makes a written determination supported by specific findings that a payment bond in that amount is impractical, in which case the amount of the payment bond shall be set by the contracting officer. In no case shall the amount of the payment bond be less than the amount of the performance bond.

The Miller Act payment bond covers subcontractors and suppliers of material who have direct contracts with the prime contractor. These are called first-tier claimants. Subcontractors and material suppliers who have contracts with a subcontractor, but not those who have contracts with a supplier are also covered and are called second-tier claimants. Anyone further down the contract chain is considered too remote and cannot assert a claim against a Miller Act payment bond posted by the contractor.

A subcontractor or supplier who has a direct contract with the prime contractor has no duty to provide any notice to the prime contractor before filing a suit on the bond. When the claimant is a second-tier subcontractor or material supplier, however, formal notice must be given to the prime contractor within 90 days of the last date the claimant furnished labor or materials for the project.

The final step in perfecting a claim on a payment bond is filling a lawsuit. For both first and second-tier claimants, suit must be filed no sooner than 90 days after the last labor and material were furnished and no later than one year after that date.

Many states in the U.S. have adapted the Miller Act for use at the state level. These state statutes are known as Little Miller Acts.

## **Recommendations**

The Office of Performance Review recommends that the Purchasing and the Public Works verify the authenticity of each bond through careful assessment of the bond format.

These are the recommended procedures for checking performance bond authenticity:

### **1. Departmental Check (Internal)**

#### **Recommended: Mr. Dean Tucker – TDOT Construction Contract Officer**

- a. Check the names and signatures on the performance bonds, and see that they match all the information concerning the bond, ie... insurance coverage attachments, power of attorney forms, and payment bonds.
- b. Contact the holders or insurers of the bond using the authenticity telephone numbers provided on the performance bonds themselves, and especially on the power of attorney forms attached.
- c. Check that the power of attorney forms have a verification number that can be easily checked over the phone. If a performance bond does not have a power of attorney form, the bond may not be valid.
- d. If no contact information, phone or verification numbers are found on the bonds or power of attorney forms, the bond may not be valid.

### **2. Detailed Authenticity and Validity Check (Internal)**

#### **Recommended: Ms. Sharon Rollins - MTAS Public Works Consultant**

- a. The contract document for performance bonds is a well accepted, standardized form, used universally. It can be found on pages 16-17 of



MTAS' Standards and Specs located at

<http://www.mtas.utk.edu/public/web.nsf/search/Home?Opendocument> .

- b. A contractor list may be used to verify legally reputable contractors working in Tennessee at  
[http://www.state.tn.us/commerce/reports/contract/1801/qual\\_agent2.html](http://www.state.tn.us/commerce/reports/contract/1801/qual_agent2.html) .
- c. The owner and his engineer have a responsibility to award contracts to the lowest, **responsible** bidder. Therefore, the contractor's reputation is of importance, the owner should ask for and follow up on references and not use unknown contractors or those of poor reputation. [ the old maxim - let the buyer beware applies here]
- d. The real burden of ascertaining the capability and reputation of the contractor comes back to the surety agency issuing the performance bond. Bond companies usually look for: no surety defaults in the contractor's past; clear personal and business credit history; strong personal and business equity; no prior personal or business bankruptcies; and successful prior performance. Surety companies will use financial statements, bank reference letters, and current work on hand, etc... to make judgments about risks.
- e. As you will note from the performance bond language - the entire purpose is to safe harmless the owner in case the contractor fails to perform the work (1) on-time and (2) in accordance with engineering plans and specs.

### **3. A.M. Best Rating and Commerce and Insurance Tennessee.Gov Website License Roster (**External**)**

- a. The department should visit the A.M. Best website at <http://ambest.com>. The department should check the solvency of each surety for validity and authentic reputation.

- b. Search the Tennessee.gov website at <http://www.state.tn.us> to verify current Tennessee licensed contractors.

*For more information about  
surety bonding, please contact the:*



**Surety Information Office**

5225 Wisconsin Avenue NW, Suite 600  
Washington, DC 20015-2014  
(202) 686-7463 | Fax (202) 686-3656  
[www.sio.org](http://www.sio.org) | [sio@sio.org](mailto:sio@sio.org)

*The information source on contract surety bonds.  
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**The Surety Association of America**

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**National Association of  
Surety Bond Producers**

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